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MICROFINANCE IN INDONESIA
An Assessment of Microfinance Institutions Banking with the Poor

by

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Abstract

Indonesia is a country with a deregulated policy environment in which microfinance institutions (MFIs) abound. Between 1970 and 1993 poverty has been drastically reduced from 60% to 14%. Three factors have been instrumental: explicit government policies, sustained economic growth and, since 1983, financial and economic deregulation. In the framework of a wider UNDP-supported program of the Asian and Pacific Development Centre in Kuala Lumpur on *Microfinance for the Poor in Asia-Pacific,* four MFIs were selected from Indonesia and analyzed in terms of outreach to the poor, resource mobilization, viability and sound (*best*) microfinance practices: a Grameen Bank replicating institution, a private rural bank, a national poverty lending program and an NGO-owned commercial bank. The Indonesian experience shows that only financially viable institutions can reach the poor in significant numbers, and how viability and sustainability can be attained in banking with the poor and the near-poor. Data from Bank Shinta Daya, which combines individual and group technologies, indicate that the latter cover their costs and greatly increase the bank's outreach to the poor as a new market segment, but initially add little to the bank's overall profitability.

Microfinance in Indonesia

1. Country overview

Indonesia has come to be considered by many, including World Bank sources, a model country: both with regard to its success in poverty reduction in recent decades and with regard to the vigor and diversity of its microfinance sector as it evolved over the past one hundred years. Since 1983 it has also provided an outstanding example of the direct impact of financial and economic liberalization policies on microfinance and poverty alleviation, proving beyond doubt that *policies work*. Decision-makers in countries that are just about to embark on such a course may greatly benefit from a thorough exposure to some of the experiences in Indonesia.

a. Macroeconomic performance

Since 1983 Indonesia has pursued, with considerable success, a policy of growth and stability based on the gradual deregulation of the financial and real sector and on budgetary restraint. During the period of 1990-1995 the gross domestic product grew on the average at 7.0%, its population at 2.0% and per capita income at 5.0 percent per year. Until the end of the century the population is projected to grow on the average at 1.9% per year, GDP at 6.0% per year and GDP per capita at 4.0% per year.

Table 1.1: Inflation, exchange and interest rates in Indonesia during 1990-1995

Year	Inflation Rate	Exchange Rate	Changes	Average lending rate		Av. fixed Deposit Rate
				Working Capital	Investment	
1990	7.8 %	1,905	---	21.0 %	20.2 %	17.75 %
1991	9.5 %	1,997	4.8 %	25.1 %	19.3 %	21.18 %
1992	6.9 %	2,074	3.8 %	22.1 %	18.4 %	21.13 %
1993	9.7 %	2,118	2.2 %	18.0 %	16.0 %	16.25 %
1994	8.5 %	2,205	4.1 %	17.0 %	15.0 %	12.96 %
1995	9.4 %	2,305	4.5 %	19.3 %	16.0 %	16.22 %

Sources: Central Bureau of Statistics: Indonesia Economic Report 1994; Bank Indonesia: Indonesian Financial Statistics, March 1996.

The inflation rate during the period of 1990-1995 was maintained at one digit, the lowest 4.6% in 1992 and the highest 9.7% in 1993. The Rupiah lost on average 4% of its US$ value during that period.

b. Poverty incidence

The extent of poverty has been drastically reduced in Indonesia since 1970: from 60 % in 1970 to 14 % in 1993. Three major factors have been cited: explicit government policies, sustained economic growth and, since 1983, financial and economic deregulation. Annual rates of poverty reduction have been substantially higher after the deregulation of 1983 than before. Microfinance has played a role in that process.

Officially the poor are categorized as those people who live below the poverty line defined by the Bureau of Statistics as the capability to afford expenditures for 2100 calories of food per capita per day plus expenses for essentials like housing, fuel, clothing, education, health and transport. In 1993 this was equivalent to an annual per capita income of Rp. 258,000 (US$121) or Rp. 334,000 (US$158) in urban and Rp. 219,000 (US$103) in rural areas.

Poverty distribution varies from province to province, but the largest number of poor people is found on Java, by far the most populous island of Indonesia. In 1993 the poor on Java comprised 58% of the total number of poor people in Indonesia. The highest incidence of poverty was found in East Timor, Maluku, East and West Nusa Tenggara, West, Central and South Kalimantan. On the whole, the incidence of poverty and degree of poverty is greater, although more variable, in eastern Indonesia due to isolation, difficult agroclimatic conditions, poor infrastructure, and low level of commercial activities and economic growth.

Table 1.2: Provinces with high incidence of poverty in Indonesia, 1990 and 1993

Province	1990	1993
East Timor	43.0 %	36.20 %
Maluku	29.0 %	23.93 %
West Kalimantan	24.0 %	21.84 %
East Nusa Tenggara (NTT)	28.0 %	25.05 %
Central Kalimantan	24.0 %	20.81 %
West Nusa Tenggara	23.1 %	19.52 %
South Kalimantan	21.0 %	18.61 %

In their microcredit design study of 1993, Development Alternatives Inc. and P.T. Indoconsult identified the following prominent poverty characteristics: Female household heads (generally divorcees and widows); elderly - over 65 years of age the majority of whom are women; un-, under- and intermittent employment; fishermen who do not own boats; agricultural laborers; plantation and factory workers paid below minimum wage; petty traders; low-paid artisans; unskilled construction workers and miners; tenants and sharecroppers; owners of less than a quarter hectare of agricultural land; shifting cultivators; tribal people; people living in isolated villages; hunters; sea nomads; transmigrants and resettled families; urban village residents in congested areas with inadequate facilities; recent migrants to the city living and working in the informal sector; and scavengers.

c. Poverty alleviation programs

Several programs have been developed to alleviate poverty, such as P_4K (Income Generating Project for Marginal Farmers under the Ministry of Agriculture in cooperation with BRI), BRI-Udes (Rural credit and savings by a state-owned commercial bank, BRI), PHBK (Linking Banks and Self Help Groups under Bank Indonesia, the central bank), UPPKA (Income-Generating Project for Family Planning Participants) and IDT (Presidential Instruction on Backward Villages).

The most recent and largest poverty alleviation program is *Inpres Desa Tertinggal (IDT)* No. 2/1993 or *Presidential Instruction on Backward Villages* issued in August 1993. It is based on the positive experience of PHBK, P4K, UPPKA and other projects working through financial self-help groups. It is a national program centering on poor villages rather than poor households or individuals. The villages are identified through economic and social infrastructure indicators. Approximately 34% of rural villages, or 20,633 in absolute terms, are covered by the IDT program.

IDT is to channel up to US $ 200 million each year to over 20,000 villages most of which are to receive Rp. 20 million (US $ 8,800) per year for three years. IDT program fund allocation for 1994/95 amounted to a total of Rp. 438,332.6 million. It consisted of Rp. 412,660.0 million in direct loan funds for poor groups and Rp. 25,672.6 million for operational expenses (5.9% of the total). For 1995/1996 the total is Rp. 473,729 million, consisting of Rp. 441,880 million for direct lending and Rp. 31,849 million for operational expenses (6.7% of the total).

The IDT funds are provided to self-help groups (Kelompok Masyarakat, POKMAS) consisting of poor families. Decisions are decentralized and fall under the authority of the village head. To guide the groups and their members, the village head is assisted by local bodies such as LKMD (community planning board), PKK (family welfare association) and community leaders. The design of IDT-supported activities at the local level incorporates facilitators whose role is to participate in the establishment of a group and its operations. They may be recruited from field workers of various government agencies or social organizations at the subdistrict levels, or they may be teachers or professionals living in the village. An additional component of IDT is rural infrastructure development for improved access to markets, health services, training and employment opportunities, and for rural institution-building.

IDT funds are onlent by the self-help groups to their members on the basis of an approved plan for their utilization, mainly as working capital. Loans have to be repaid with interest. The IDT allocations are expected to be seed money for viable and ultimately self-reliant local financial institutions modeled after semiformal institutions such as BKK (Central Java), LPD (Bali) or LNP (West Sumatra) to be eventually transformed into formal village banks (BPR).

Like any large-scale government program IDT is fraught with hazard. An evaluation mission concluded in April 1995 that there is no guarantee that the project results are sustainable, the most immediate result of this project, improved understanding of the IDT program on the part of the villagers, being constantly undermined. Furthermore, the structures designed to provide community assistance have been largely ineffective and failed to be committed to the principles of participatory development. Facilitators have no skill in the preparation and implementation of business plan; they have little production or commercial experience and tend to recommend activities with limited scope for profit. One may surmise that IDT will only be successful to the extent that concerns for institutional viability and sustainability will outweigh the concern for short-term political gains from liberal disbursement of funds.

d. Financial institutions and their outreach to the poor

Access to credit has been considered by the government as a major instrument in the promotion of equitable growth and the reduction of poverty. Since the early 70s, the government has used two major instruments of promoting access to credit: the provision of subsidized credit mainly through government banks; and the establishment of semiformal financial institutions at the provincial level which largely mobilized their own resources and were exempt from the interest rate regulations that prevailed until mid-1983. The subsidized credit approach was largely given up as ineffectual and wasteful in 1990 when 30 of the 34 major programs were scrapped. Microfinance constitutes a growing business for government-owned Bank Rakyat Indonesia with 3,500 sub-branches, the 9,000 registered local financial institutions as well as numerous other private and public banks, plus the hundreds of thousands of informal institutions. They provide financial services to a segmented market of the poor, the not-so-poor and the non-poor the market shares of which are not exactly known.

According to the Banking Act of 1992, Indonesia's financial system comprises bank and non-bank financial institutions. Only two types of banks are recognized by the law: commercial banks and rural credit banks (Bank Perkreditan Rayat, BPR). There are two major institutional providers of financial services in rural areas: some 9,000 formal and semiformal MFIs; and government-owned Bank Rakyat Indonesia (BRI) with some 3,500 sub-branches (*unit* or *unit desa*) at sub-district level.

Rural MFIs are quite heterogeneous. They are classified into: BPR-Non-BKD, BPR-BKD and LDKPs/SFIs (Lembaga Dana dan Kredit Pedesaan/ Small Financial Institutions). The banking law of 1992 provides rules for the establishment of a fully licensed Rural Credit Bank (BPR) under central bank supervision and the transformation of LDKPs into BPR (BPR Non-BKD). The minimum paid-up capital for a new BPR is Rp 50 millions (US$ 22,500). A new BPR cannot operate within the provincial and district capital cities. It is only allowed to operate within the subdistrict where it is located (though it appears that this rule is not rigidly enforced). The second type of BPR is BPR-BKD. BKD (Badan Kredit Desa), is village-based hitherto semiformal financial institution established and owned by local villages and supervised by BRI. The third type of BPR is called LDKP (Lembaga Dana dan Kredit Pedesaan) or *rural fund and credit institution*, such as BKPD (Bank Karya Produksi Desa), LPK (Lembaga Perkreditan Kecamatan), BKK (Badan Kredit Kecamatan), KURK (Kredit Usaha Rayat Kecil), LPD (Lembaga Perkreditan Desa) and LKP (Lembaga Kredit Pedesaan), LPN (Lumbung Pitih Nagari). LDKPs were sponsored by provincial and local governments in the early 1970's as non-licensed rural credit institutions. They fell under provincial law and were usually supervised by the provincial development bank (BPD). These LDKPs are now required to receive a BPR license within five years or close down.

Until 1983 BRI was a major provider of subsidized targeted credit in rural areas, with a repayment performance around 40%. After the deregulation of June 1983, it carefully crafted two commercial products: a rural savings scheme with a lottery component (SIMPEDES) to mobilize its own resources at village level; and a rural credit scheme (KUPEDES) which operated on market terms. All its sub-district operations were commercialized, i.e. the banking units were turned into profit centers; and they were to mobilize their own resources, cover their costs from the margin, and recover their loans (which they did at a rate of 97.5%) - lest sub-branch managers lose their credit authority (and opportunities for promotion). All other operations, particularly programs carried out on behalf of the government and of donors, were kept from sub-district branches and confined to the branch level. With this model, BRI became one of the most successful banks with a rural mandate in Asia-Pacific, serving by the end of 1996 some 18 million clients, with its rural banking network completely self-reliant (fully mobilizing its own resources) and viable (covering its costs from the margin and making a profit from which the expansion of the system is being financed). Data on microfinance services by MFIs and BRI are presented in the following table.

Table 1.3: Formal and semiformal financial institutions in Indonesia (Dec. 1995)

Amount (Rp billion)

Type of financial institution	Number	Credit		Funds mobilized		Total financial services	
		Accounts	Amount (Rp bn)	Accounts ('000)	Amount (Rp bn)	Accounts (000)	Amount (Rp bn)
1. BPR (Rural Credit Bank) and Secondary Banks	1,948	1,232	1,566	2,969	1,226	4,252	2,792
2. LKPDs (Small Financial Institutions)	1,978	261	224	456	118	716	342
3. BKDs (Village Credit Body, include BPR ex BKD)	5,435	955	93	1,176	63	2,130	156
Sub-total MFIs	9,271	2,448	1,883	4,601	1,447	7,098	3,290
4. BRI-UDES	3,482	2,264	3,194	14,483	6,016	16,747	9,210
TOTAL	12,743	4,712	5,077	19,084	7,463	23,845	12,500
5. Commercial Banks	240	91,168	234,611	49,904	214,764	141,072	449,375

Sources: 1. Bank Indonesia: Annual Report 1995/96, May 1996; 2. Indonesian Statistical Report, March 1996; 3. Statistik Kredit Koperasi dan Kredit Kecil (KUK), Januari 1996; 4. Bank Rakyat Indonesia

Per 31 December 1995, 9,271 semiformal and formal MFIs provided small loans to 2,45 million borrowers amounting to Rp 1,883 billion outstanding - compared to 2.26 million borrowers of BRI sub-branches with a total volume of Rp. 3,194 billion outstanding. At the same time MFIs served 4.60 million savers and mobilized savings amounting to Rp 1,447 billion - compared to 14.48 million savers at BRI sub-branches and Rp 6,016 billion in savings.

BRI thus outperforms the totality of MFIs by a considerable margin: 16.75 million microfinance accounts in BRI vs. 7.10 million accounts in over 9,000 MFIs. However, while they are competitors, their competition serves a healthy purpose: to increase the supply of financial services to the lower segments of the rural population. Together, they provide for 4.51 million loan accounts and 19.08 million savings deposit accounts, totaling 23.6 million accounts.

The average loan size of MFIs is Rp 0.77 million (US$334) while average savings amount to Rp 0.31 million (US$234) - compared to an almost twice as high average loan size in BRI of Rp 1.41 million (US$512) and average savings of Rp. 0.42 million (US$182) which are only one-third higher than those in MFIs.

As almost everywhere in the developing world, rural finance is but a fraction of overall financial services within the country. Commercial banks (including BRI!) in Indonesia provided 91.17 million loans amounting to Rp 234,611 billion, averaging Rp 2.57 million (US$1,115). They recorded 49.90 million savings deposit accounts amounting to Rp 91,404 billion, averaging Rp 1.83 million (US$734). The lending volume of MFIs is thus only 2.2% of that of the commercial banking sector; while MFI savings deposits are equivalent to only 0.7% of commercial bank deposits. In terms of outreach, which is somewhat difficult to determine as figures relate to accounts rather than clients, MFI loan and savings accounts amount to 7.8% and 9.5%, respectively, of those of commercial banks. However, a number of national and provincial commercial banks do provide a considerable volume of microfinance services in rural and urban areas. No data are available to determine the exact proportions. The overall volume of microfinance services in Indonesia may thus be somewhat higher than indicated by the figures on MFIs and BRI.

Perhaps one of the most remarkable features of microfinance in Indonesia is the sector's self-financing capacity. Together, BRI and MFIs fully finance their lending operations from internal resources, but BRI more so than local MFIs. Starting its commercial operations with market rates of interest in 1984, BRI first broke even in terms of matching the volume of its rural savings and credit operations in 1990; since then, demand for savings deposit facilities have grown at a much faster rate that credit demand, with the result that by the end of 1995 the ratio of borrowers to savers was 1:6.4 and the ratio of the volume of loans outstanding to savings deposits 1:1.89. By comparison, the ratio of MFI borrowers to savers was 1:1.9 and the ratio of the volume of loans outstanding to savings deposits 1:0.77. This means that BRI's most outstanding achievement lies in the field of deposit mobilization. This is all the more remarkable as BRI as a government-owned agricultural development bank was accustomed, until 1983, to obtained most of its resources from the government at preferential terms.

BRI's rural financial operations have been very profitable. The consolidated totality of microfinance institutions however has been taking losses in recent years: Rp 27 bn in 1993, Rp 26. bn in 1994 and Rp 22 bn in 1995, amounting to 1.6%, 1.3% and 0.9%, respectively, of financial operations. In the three preceding years, the sector as a whole showed substantial profits amounting to 1.5% of its financial operations in 1990, 2.2% in 1991 and 1.5% in 1992.

e. Regulatory framework

Starting in June 1983 Indonesia has gradually and consistently deregulated its financial system. This has been paralleled by the deregulation of its foreign trade regime. The liberalization of the monetary and banking system proceeded in the following way:

- 1983: Interest rate autonomy is given to all banks, state-owned and private. Bank Indonesia (BI) as the central bank drops direct interest rate controls and adopts market-oriented monetary policies. Between 1983 and 1990 savings mobilization increased 6.7-fold, bank loans outstanding 6.4-fold. From 1990 to 1995 savings mobilization increased 2.5-fold, bank loans outstanding 2.4-fold.

- 1988: BI deregulates the institutional framework by easing the establishment of new banks and the opening of branch branches. A new rural banking law was passed, permitting the establishment of rural banks (BPR) with an equity capital of Rp. 50 million, requiring the existing semiformal financial institutions to be eventually transformed into formal banks (BPR). 1,643 formal rural banks (BPR were established until 1995. The total number of registered small financial institutions grew from 8,003 in 1990 to 9,271 in 1995. During the same period the number of commercial banks increased from 171 to 240 and the number of their branches from 3,563 to 5,191.

- 1990: BI withdraws most of the interest rate subsidies. Commercial banks are required to allocate at least 20% of their portfolio to small, either directly or through BPR (with little if any direct benefit to the poor).

- 1991: In response to some spectacular bank failures, BI steps up bank supervision and imposes a capital adequacy ratio.

- 1992: A new banking act deregulates bank ownership. Only two types of banks are recognized: commercial banks with a paid-in capital of Rp 10 billion and rural banks (BPR) with a paid-in capital of Rp 50 million.

With the deregulation of interest rates in 1983, financial services in terms of savings deposit facilities and credit for the lower sections of the population have greatly increased, particularly through government-owned BRI (*People's Bank of Indonesia*), provincial government-owned BPDs and a number of private banks and smaller institutions. None of them has exclusively targeted the poor, but has included the poor among their clientele.
With the bank deregulation of 1988, the number of village banks and rural branches grew rapidly, increasing the outreach of this banking segment to both the non-poor and the poor. This deregulation has also increased competition, forcing small institutions like Bank Shinta Daya, our second case study from Indonesia, first to register as a BPR and then to increase its outreach. This bank did so, among other things, through the addition of the group approach as a cost-effective approach of banking with poor, almost doubling the number of its borrowers and increasing the number of its savers by about one-third. The new banking law of 1992 also requires all registered MFIs in Indonesia to be transformed within five years into formal village banks. Some NGOs, among them Yayasan Bina Swadaya as one of the leading institutions, have been inspired by the law on village banks to establish their own banks. Very few MFIs target exclusively the poor, but many do include the poor among their clientele. These are the financial institutions that have helped to reduce poverty in Indonesia by giving the poor access to savings and credit services.

There are also hundreds of thousands of informal self-help groups with savings and credit activities, either of indigenous origin or founded by GOs or NGOs. There are numerous programs, most under NGO guidance, that have demonstrated the ability of either upgrading the capacity of existing SHGs or establishing new SHGs. Most importantly, under the umbrella of central bank permission, an increasing number of them has gained access to banks, particularly through Bank Indonesia's own linkage banking program (PHBK). In the process substantial training capacities have been build up in NGOs geared at the upgrading of self-help groups; and the promotion of linkages with national, regional and local banks.

2. Microfinance Capacity Assessment

Out of a vast number of institutions and programs with microfinance services in Indonesia, four case studies focussing fully or partially on the poor have been selected, each with a special story to tell:

- Mitra Karya of East Java (**MKEJ**) established in 1993, a Grameen Bank replicator with funding from the Grameen Trust Fund and Bank Negara Indonesia and implemented by the Research Center of Brawijaya University in East Java

- **BPR Bank Shinta Daya,** a self-financed private village bank established in 1970 in D.I. Yogakarta on Java which in the past dealt mainly with individual clients but inspired by BI's linkage banking program also adopted the group lending approach

- **P4K** (Proyek Pembinaan Peningkatan Pendapatan Petani Kecil - Income-generating Project for Small Farmers) first established in 1980/81 and restarted in 1989/90, a large national poverty-lending project of the Ministry of Agriculture and BRI with substantial financial assistance form IFAD and technical assistance from UNDP

- **Bank Purba Danarta** in Semarang, Central Java, established in 1990 as a commercial bank with financial assistance from Misereor, Germany, by an Indonesian NGO that was established in 1963. This NGO had a longstanding experience in the promotion of microenterprise activities among the poor including microsavings and microcredit programs since 1973. By setting up a bank of its own the NGO was able to formalize its savings and credit operations on a commercial basis

Of the four cases, **BPR Bank Shinta Daya** has been singled out for a more elaborate presentation. To readers familiar with donor-supported approaches to banking with the poor, Bank Shinta Daya presents an outstanding example of a private institution that is self-reliant in terms of resource mobilization, financially viable, has financed its expansion from profits, and has substantially increased its outreach to the poor as a market segment on commercial terms. As it employs both the individual and group methodology of financial services, it also permits an assessment of the effectiveness of the two strategies. Its five private founders established the then *PT Bank Madya Shinta Daya* as a limited liability company with an equity capital of Rp 1.0 million (US$40,000 at the 1970 exchange rate) in the subdistrict of Kalasan-Prambanan. Prambanan being the site of a famous Hindu temple dating back to the 8th century, the bank derived its name and philosophy of lending to the rural people including the poor from Dewi Shinta who stands for honesty and self-reliance. Operations started on August 20, 1970, with a staff of eight in a small building of 80 m² floor space. The bank, which is far from unique in its outlook and operations, has grown considerably since then but has retained its modest appearance.

a. Outreach

Specialized programs with a sole or major focus on the poor have had a limited outreach. Using end-1995 data, the outreach of the institutions and programs covered by these four case studies in terms of borrowers was only 9.7% of that of BRI and 4.7% of BRI and MFIs combined. Their outreach in terms of savers was 2.6% of that of BRI and 1.9% of BRI and MFIs combined. It is probably safe to say that all special savings and credit programs of governmental and non-governmental agencies together do not reach more than 10% of the number of customers of BRI and MFIs combined. While the role of these special programs on a national scale is small with regard to access to credit, it is almost negligible with regard to access to savings deposit facilities. However, some of them have made illuminating inroads into the market segment of the poor and demonstrated how the poor can be reached by institutional finance in cost-effective ways.

An example of very restricted outreach is a Grameen replication project, **MKEJ** in East Java, our first case study. In 1993 it started with 105 participants organized in 21 small groups. In 1994 it expanded to 178 groups with 889 members and in 1995 to 225 groups with 1125 members all of them women. Following the Grameen Bank system, it strictly adheres to a group size of five a cultural novelty on Java where almost every woman and man belongs to a multitude of groups, including financial self-help groups of a much larger size. The project is now under consolidation, with limited expansion capacities. MKEJ strives for what it considers its optimum size of 2000 members in 400 groups as of 1998. Pointing to the restricted outreach of MKEJ does not as such imply any criticism as it is up to each institution to define the area covered and the size of its market - as long as the institution is viable (as is the case in many self-help groups). There is certainly a place for small institutions with a purely local outreach. However, MKEJ might run into trouble with the regulator as it is unlikely to achieve the size required for registration as a formal rural Bank (BPR).

Bank Shinta Daya, our second case study, is a rural bank that was established with private money and funded its expansion from profits, not subsidies. With 43,000 accounts and a clientele of over 30,000, comprising 30,340 savers and 12,656 borrowers as of Dec. 1995, it has shown that privately owned village banks can have a considerable outreach at the local level that does not need to be subsidized. Moreover, as it records 69% of its borrowers and 85% of its savers as poor, it has also demonstrated that financial services to the poor by private banks can be profitable and self-sustained.

For the first twenty years of existence the bank indistinctively mobilized savings from, and lent to, the non-poor as well as the poor in its area of operation. Given the relatively high transaction costs of collecting micro savings and small installments on microloans, the bank made no conscious effort of financial deepening among the poor. This began to change in 1989 when Bank Shinta Day started to participate in a project *Linking Banks and Self-Help Groups* under the umbrella of Bank Indonesia. After an expensive and ultimately abortive attempt of working through a local NGO as a financial intermediary, Bank Shinta Day decided to seek out its own savings and credit groups which are ubiquitous in Indonesia. The bank has set up a special group lending department, hired its own field workers, some of them former NGO staff, and trains its own groups of the poor in group management, bookkeeping, savings mobilization and financial management. As of 12/1995, the bank effectively worked with 310 groups comprising 7750 members. This has allowed the bank to virtually double its outreach to borrowers from 6,456 to 12,656 and to increase its outreach to savers by about one-third from 22,940 to 30,340.

The impact of the newly introduced group approach is most dramatic with regard to access to credit to the poor. As of 12/1995 the bank lent to 2,582 poor borrowers individually. The group approach added to this another 6,200 or 240%, bringing the total number of poor borrowers to 8,782, which is 69% of all the bank's borrowers. Without the group approach, the proportion of poor borrowers would have been only 40%. By comparison, the impact of the group approach on access to deposit facilities has been undramatic: As of 12/1995 the bank counted 18,352 individual poor depositors to which the group approach added another 7,400 or 40%, bringing the total up to 25,752 poor depositors. Without the group approach, the poor make up 80% of the bank's depositors. The group approach has increased the share of the poor to 85%. All in all, 80% of the accounts in the bank are held by the poor. Without the group approach, this percentage would have been 71%.

The following conclusions can be drawn from the experience of Bank Shinta Daya: (a) Private rural banks can and do provide financial services to the poor; (b) the non-poor are somewhat more likely than the poor to be borrowers while the poor are far more likely to utilize the bank's deposit facilities than the non-poor; (c) the group approach extends the outreach of the bank to the poor; (d) in terms of additionality and financial deepening, the group approach is most successful in providing access to credit for the poor; (e) there may be an additional impact of bank access on the volume of internal savings and credit operations within the groups, which was beyond the scope of this study.

The biggest outreach example is probably **P4K**, our third case study, a national poverty alleviation program with a rapid expansion rate. Using the most recent data for 3/1996 as presented during the *Bank Poor '96* workshop, P4K now reaches 486,000 carefully screened poor and very poor families (with a per capita income equivalent to less than 320 kg, or 240 kg., respectively, of rice per annum) in 45,400 groups and 2,762 self-organized associations with their own autonomous savings and credit activities. 37,300 of the groups are active borrowers. The remaining 18% of the groups are either under preparation, have died or have opted for self-reliance. However, despite its spectacular growth, P4K still has reached less than 10% of the population officially recorded as poor. During the six-year period, 3/1990-3/1996, bank and internal group savings have surged from Rp. 66 bn to 6,360 bn; credit disbursed from Rp. 886 bn to 74,956 bn. Its impact has been remarkable, though data gathered from the informal sector need to be interpreted with great caution. According to an evaluation by IFAD, income has increased by 33% after the first loan and 46% after the third loan, to which indirect multiplier effects from multiple reinvestiments have to be added. 82% of the beneficiaries report an increase in the volume, and 65% in the quality, of production. Employment in each beneficiary household has gone up by 27 hours per week. There are also psychological and social effects on the self-confidence of the poor and their standing within the community. In addition, there are institutional effects with regard to the emergence of self-sustained savings and credit associations at the grassroots level and the building of a group formation and guidance capacity within the ministry with its unique delivery structure of 33,000 field extension workers.

P4K has successfully tested and applied a technology of organizing the poor in self-help groups and giving them access to financial services. P4K, by mobilizing vast number of self-help groups through Ministry of Agriculture extension staff and, more recently, supplying training inputs geared at financial viability of group associations through participating NGOs under Bank Indonesia's PHBK, has supplied the government with a highly efficient technology in its present poverty eradication program, IDT.

A particularly interesting case is **Bank Purba Danarta** in Semarang, our fourth case study. As an NGO with a social mandate, Purba Danarta has focussed on financial services to the poor, particularly the financing of their income-generating activities. To put its activities on a legal basis, it made use of the deregulation of 1988. With substantial donor assistance it established a commercial bank in 1991 with an equity capital of Rp. 10 bn (5 million US$ at the 1991 exchange rate), only to find out that it takes substantial capacity-inputs until a bank of that size has trained the staff to serve vast numbers of the poor. Through a unique system of ambulant bankers who are the bank's substitute for branching out, its clientele by the end of 1995 comprised 13,315 accounts (the number of physical clients being smaller, presumably less than 12,000), 89% of them savings accounts and 11% debit accounts. 91% of its savers, but only 37% of its borrowers, are poor. Under pressures of viability, the bank is forced to concentrate its business, in terms of volume, on the non-poor. At the same time, it is swamped by savings. It finds itself unable to expand its lending business at the same rate and is left with a huge liquidity surplus. With less than 500 poor borrowers, the poor can hardly be said to be benefiting from the donor supply of a sizeable amount of equity. However, this is not due to a lack of effort and commitment of the bank to reach the poor. Instead, it has been the poor who, given the choice between saving and borrower, opted for the former.

The inadequacy of the various approaches to fully eradicate poverty has caused great concern in the office of the president which has, in 1992, declared war on poverty with a focus on poor villages through **IDT**. Discussions were held on whether this objective was best achieved through a massive supply of subsidized credit or through a strengthening of institutions supplying microcredit at market rates. The final decision was in favor of a **combined group lending and local financial institution-building approach** modeled after the P4K and PHBK experience. Up to US$ 200 million are lent annually to 20,633 poor villages, each of which may receive Rp 20 million ($88,000) per village for three years. Funds are onlent by the groups to their members at locally determined terms. With the help of facilitators of widely varying competence, the groups are required to either evolve into an autonomous local financial institution, or merge with an existing one.

There is a notable absence of financial institutions or programs of any significance specialized on **women** in Indonesia. To varying degrees, women are part of the market of any financial institution; but most of them have no financial products differentiated by sex, nor do they report sex-specific data.

In microfinance, women have usually been found to be the better savers and more reliable borrowers; however, they have also tended to be the smaller savers and investors. Few formal institutions, including formal and semiformal MFIs, have focused on women only. It would be unthinkable for a national bank like BRI or a private rural bank like BPR Shinta Daya to mainly focus on women. There is usually a wide scope of widening, but not limiting, their outreach to women. The group approach can be particularly helpful in that respect. Informal financial institutions of the ROSCA type are almost considered a female monopoly in Indonesia; upgrading them would greatly contribute to financial deepening for the women participants and indirectly contribute to their outreach – a deepened outreach in this case. Special programs focusing solely on the poor like P4K made the experience that a strong though not necessarily exclusive focus on women will greatly contribute to the viability of the program and also be more effective in poverty alleviation in terms of donor investment. If this course is further pursued, it might have paved the way for transforming, with TA, project operations into large numbers of autonomous local MFIs owned and run by women.

In the table below, summary data as of December 1995 are given on **outreach of the four institutions** covered by the case studies: Grameen replication project MKEJ for some 1,125 women; Bank Shinta Daya, a rural bank with about 30,000 customers; Bank Purba Danarta, a new NGO universal bank with close to 11,000 customers; and P4K with some 330,000 participants (1995) below the poverty line, about half of them women.

Table 2.1: Outreach of four MFI in Indonesia, 1995*

MFI	Number of borrowers	% of poor borrowers	Number of savers	% of poor savers
MKEJ	1,078	100%	1,125	100%
Bank Shinta Daya	12,656	69%	30,340	62%
Bank Purba Danarta	1,322	37%	11,893	91%
P4K	203,790	100%	328,670	100%

* Some of the data given in the text are more recent than December 1995. The original data on P4K were on groups of an average size of ten members. Borrowers and savers normally overlap and cannot be added up. In programs with a forced saving component the number of savers usually equals the total number of participants; in banks the total number of customers is likely to be somewhat larger than the number of savers. Bank Shinta Daya and Bank Purba Danarta, like any bank, give no breakdown by sex of customer.

In sum, Indonesia has made great progress in extending financial services to almost all segments of the population. Instead of replicating successes of other countries, Indonesia, over a period of over a hundred years, has found its own unique way of coping with poverty and rural finance. In rural and microfinance, Bank Rakyat Indonesia with its almost three million small borrowers and now almost eighteen million small savers is perhaps the biggest single provider of financial services. Numerous other banks, including provincial government-owned banks (BPD) and private banks like Bank Dagang Bali have extended their services to the poorer sections of the population, including self-help groups of the poor. The 9,000 registered MFIs 1,650 of them banks, the others semiformal financial institutions not falling under the banking law represent a financial infrastructure which can potentially serve a large proportion of the population spread over 60,000 villages and cities. However, there are still poor areas and pockets of poor people that have been left out. **How can they be reached?**

If there is one major conclusion to be drawn from the Indonesian experience it might read: **It is viable financial institutions that reach the poor; but programs can pave the way!** The main emphasis of any further attempt at poverty alleviation must concentrate on institution-building: the establishment and upgrading of institutions owned by the poor, and of institutions providing services for a clientele that includes the poor.

It is clear that no single approach or single type of institution will achieve this end. A **systems approach to microfinance** may be needed which promotes the access of all segments of the population to the services of financial institutions through a variety of strategies and gives special emphasis to the poor as a market segment and, at the same time, as potential owners of member-based financial institutions (MBIs):

- Assist informal financial institutions to upgrade their financial operations and acquire an appropriate legal status, thus evolving into semifinancial institutions with deepened services and increased outreach

- Assist semiformal financial institutions to upgrade their financial operations and evolve, where feasible, into village banks (BPR)

- Assist informal, semiformal and formal MFIs to link up with banks as refinancing institutions, thus strengthening their financial service capacity and deepened outreach.[1]

- Assist the poor in poor villages, in the informal sector and in pockets of poverty to organize themselves in self-help groups by using the P4K experience; assist them in upgrading their activities and in gaining access to the financial services of banks

- Assist MFIs to open a window for targeting the poor through the group approach, linking the MFI to existing self-help groups

- Assist poverty alleviation projects in increasing women's participation and in transforming their local financial operations into autonomous local MFIs owned and run by women

- Assist rural and commercial banks in establishing business relations with MFIs to refinance their activities, thus strengthening their financial deepening and outreach.

b. Financial viability and sustainability

Only viable financial institutions with sustainable financial services can increase their outreach. The issue of viability is thus not only of relevance to the health and survival of the institutions but also to the poor themselves as clients and owners of such institutions.

Before the onset of deregulation in 1983, financial viability was not a concern in the government's subsidized credit programs. Repayment rates averaged about 40%, and billions of dollars were lost over the years, with **BRI** as one of the major disbursors involved. After 1983, government banks were increasingly forced to rely on their own resources. With technical assistance from HIID, BRI responded by converting its 3,400 village subbranches into profit centers and introducing KUPEDES, a credit scheme with market rates of interest and powerful incentives for timely repayment. To step up its resource mobilization, it introduced SIMPEDES, a lottery savings scheme that proved very attractive. Repayment rates are around 97 %. By 1990, the funds for lending at village level were fully mobilized from local savings. Since then, the number of borrowers has climbed to 2.6 million, while the

[1] *Financial deepening* refers to an increase in financial services to a given area or market segment. In discussing outreach, it is proposed to take a wider view and include both quantitative and qualitative outreach, i.e. numbers and impact.

number of savers has skyrocketed from 6 million to over 17 million in 1996. KUPEDES is the only major profit making scheme of BRI. On the whole the BRI village units became fully self-reliant and profitable within six years since 1984 proof that government-owned agricultural banks can be successfully restructured into viable institutions with sustainable financial services to the poorer (though not the poorest) sections of the population. (The costs of foreign TA is usually not included in the calculations of viability.)

The **semiformal financial institutions** established through government initiative at village (like LPN, LPD, BKD) and subdistrict level (like BKK), after an initial equity booster by the government, were meant to turn into viable institutions. As they did not fall under the banking law, they were permitted, even before the deregulation of 1983, to charge rates of interest covering their costs and producing a profit. Many of the small village-based BKDs, which fell under BRI supervision, became dormant. Of the programs under provincial bank supervision, approximately half the institutions were active. Those that fell under the USAID Financial Institutions Project (FID) turned into viable institutions with a range of credit products. High interest rates ranging from about 30% to 60% p.a. not only covered their costs but also served as a major instrument of resource mobilization, financing the rapid expansion of the program. They are proof that MFI that are registered but do not fall under the banking law can be viable by charging market rates of interest even in the adverse policy environment before 1983.

The newly established **formal sector village banks**, BPR, and the older MFIs converted into BPR like Bank Shinta Daya have usually been successful in attaining viability, covering their costs through a variety of credit products adapted to the needs of their clients including some of the poor. This seems also to apply to the BPR set up by NGOs, which mostly cater for the poor. However, if such institutions are set up as universal banks requiring an equity capital of Rp. 10 bn, as in Bank Purba Danarta, our fourth case study, the attainment of full viability may be a long way off. During the last three years the MFI sector as a whole has shown losses, indicating that a number of institutions may be in distress: an issue that needs further investigation.

Indigenous informal financial institutions, among them hundreds of thousands of rotating and nonrotating savings and credit associations and other financial self-help groups, but also moneylenders, are self-reliant from the onset, mobilizing their own resources, and they are viable, covering their costs and risks from the margin. Savings, credit and insurance services are sometimes combined in ingenious ways. Through PHBK and other programs, increasing numbers are given access to capacity-building by NGOs and to bank sources of refinance.

Considerable numbers of **solidarity groups** with financial functions have been set up in Indonesia by GOs and NGOs. Supplied with government or donor funds, such groups have rarely attained self-reliance and viability. With some success, the linkage banking project, PHBK, of Bank Indonesia and GTZ has attempted to introduce a commercial approach to them, providing training to NGOs and SHGs to turn them into viable financial intermediaries. In response, some NGOs have established their own banks while some banks have established their own groups; and most of the groups under the program are now viable, repaying their loans and covering their costs from the margin. However, access to bank refinancing has drastically increased their external resource base, simultaneously decreasing the degree of their self-reliance.

Donor-supported programs and institutions like **MKEJ, P4K** and **Bank Purba Danarta** have generally not been self-reliant as they depend to a large degree on outside resources. However, viability is feasible, though presently not in reach for the two programs.

Grameen replicator **MKEJ** reports liabilities in the form of soft loans received (outstanding as of 12/1995) to the amount of Rp 107.2 million (about half from government-owned Bank Negara Indonesia and half from Grameen Trust Fund) compared to assets in the form of loans outstanding amounting to a mere Rp 74.0 million. With an interest rate of 10% on savings deposits and 3.5% on soft loans, a lending interest rate of 30% and an on-time repayment rate of 98%, its spread should be more than sufficient to cover its costs. This is indeed the case as indicated by the a degree of partial financial self-sufficiency of 110%. However, given its dependency on donor funds, its degree of full financial self-sufficiency is only 39%. MKEJ is a young institution with a relatively costly delivery system using the Grameen Bank's small group approach. It employs a field staff of four, one on average for 56 groups with a total of 280 members. During its third year, 1995, MKEJ showed its first profits (amounting to Rp 11.7 million), excluding however the honoraria paid to the university advisory team of three and ignoring the market value of the soft loan (on which MKEJ pays only 3.5% interest), which contains a subsidy element of Rp 7.0 million if we use the rate of interest paid by MKEJ to its depositors (10%), or Rp 11.8 million if we use the average savings deposit rate paid by BPR-type rural banks (14.5%) as a calculatory basis. Moreover, all these calculations ignore the value of the time spent by the group members on their weekly meetings which substantially add to borrower transaction costs. With total assets amounting to Rp 127 million, loans outstanding of Rp 74 million and a deposit base of Rp 12.3 million and virtually no equity base, MKEJ would have to come a long way to grow into a formal village bank, BPR, which would require a minimum paid-in equity capital of Rp 50 million. So far MKEJ has not been able to demonstrate convincingly that the replication of the Grameen Bank approach in Indonesia may substantially improve the poor's access to financial services.

Bank Shinta Daya is a private rural bank that was established with private capital (US$ 40,000 in 1970, equivalent to Rp 92.2 million in 1995) and financed its expansion from its profits. Its net worth is now (12/1995) Rp. 495.8 million (US$215,000), comprising Rp 179.5 million in capital and Rp 316.3 in retained earnings. Access to subsidized funds was not of any vital importance in the history of Bank Shinta Daya. When Bank Indonesia scrapped most of its subsidized programs and instead required commercial banks to allocate at least 20% of its loan portfolio to small enterprises either directly or through rural banks, Bank Shinta Daya took advantage of this offer. In 1993 and 1994, the bank obtained these funds amounting to Rp 439.4 million and Rp 178.5 million outstanding, respectively, at interest rates below the market rate, namely at 8.0% and 9.8%, respectively. Meanwhile these rates have been adjusted. In 1995 the bank's outside funds amounted to Rp 163.0 million on which it paid 16.6% interest which is above the average three-months fixed deposit rate as well as above the average rate paid by the bank to its depositors.

The average interest rate paid to its depositors was 15.2%; the average interest rate charged to borrowers was 27.4%; the default rate was 2.0%. In 1995 the bank had access to outside funds but, unlike during the preceding years, not at a subsidized rate. Its total income as per 6/1995 amounted to Rp. 822.5 million (Rp. 785.0 million interest income + Rp 27.6 million operational income + Rp. 9.9 million nonoperational income); net profit of the year according to the balance sheet was Rp 63.3 million which is equivalent to 7.7% of its total income and

12.8% of its net worth. Other efficiency measures provided on the basis of the case study are (as per 12/1995):

Ratio of salaries to average assets: 6.3%
Ratio of operating costs to average assets: 10.0%
Ratio of financial costs to average assets: 12.9%
Return on average assets: 27.4%
Operating costs/total financial services: 16.5%
Total costs/total financial services: 22.7%
Average salary as % of GDP/capita: 325.5%
Degree of partial financial self-sufficiency: 111%
Degree of full financial self-sufficiency: 96%

Bank Shinta Daya has a field staff of 17 each of which serves an average of 1,767 customers. The bank employs two technologies: retail financial services to individuals and wholesale services through groups. By adding the wholesale technology the bank has substantially increased its outreach in terms of number of (end-) customers: Group members represent 49% of the bank's direct and indirect borrowers and 24% of the bank's depositors. However, in terms of viability, the crucial issue to the bank is: How much does the group technology add to the bank's business volume? And how profitable are the two technologies to the bank?

In terms of volume, group lending is of minor importance to the bank: 89% of the bank's lending volume goes to individual borrowers and only 10.7% to group borrowers. Group deposits are almost negligible, representing only 3% of total savings deposits in the bank compared to 97% raised retail from individual clients. Regarding profitability, the most important observation from the Bank Shinta Daya data is that both are profitable. The second observation is that the individual technology is more profitable than the group technology. 94% of the bank's profits are derived from its individual lending, only 6% from its group lending. The profit ratio of the individual technology is 2.6 of loans outstanding, the profit ratio of the group technology only 1.4% as shown in the following table.

Table 2.2: Profitability of the individual vs. group technology in Bank Shinta Daya (in %)

Item	Individual	Group	Total
Income	97.6	2.4	100.0
Expenditure	98.0	2.0	100.0

Profit	94.0	6.0	100.0
Profit/Loans outstanding	2.6	1.4	2.5
Profit/Deposits	2.3	4.5	2.4
Profit/Fin. serv's	1.2	1.1	1.2

The group technology is thus found by Bank Shinta Daya to be viable as such, but adds little to the bank's overall viability. Why then does the bank engage in business with small groups? The bank's management explains this with future expectations. By providing financial services to group members with microenterprise activities, it contributes to their growth. As the members' microenterprises grow, so will their business with bank. Besides providing a service to the community which covers its costs and even yields a profit, the bank hopes to grasp a larger market share which might pay off substantially in the future.

Can programs that are government-implemented and donor-funded be viable? When BRI as a wholesale bank for **P4K** insisted on market rates of interest and timely repayment, not only was viability approximated but outreach, which is affected by viability, substantially widened. P4K works through a field staff of 2,384 (12/1995) provided by the Ministry of Agriculture; each staff members serves an average of 14 groups with about 140 members.

P4K has taken several steps in the direction of viability and sustainability. It strengthens group associations which have spontaneously emerged in large numbers; they function as autonomous institutions, mobilizing their own resources and providing short-term credit at their own terms. The arrears ratio is still a mere 2.5%, reflecting the seriousness of the borrowers, the effectiveness of incentives set up by BRI (groups, villages and districts with arrears over 10% are automatically cut off from repeat loans) and the quality of supervision by project staff. And finally, BRI has agreed to provide refinancing from its own resources beyond the availability of IFAD funds. In the following table, some selected indicators of viability are presented. While the project is profitable to BRI as executing bank, the indicators show that P4K as a project is still a long way off financial self-sufficiency.

Bank Purba Danarta in Central Java is a commercial bank for the poor which uses field workers as itinerant banks, rather than branches. The expansion of the bank depends on its success in training field staff in which the bank invests considerable time and resources. Only university graduates are recruited; they receive 32 months of in-service training; and only 60% pass the rigid final tests. In 1995 the bank employed 56 field workers, almost double the number (30) for 1993 and 1994. On average each field worker served 339 clients, comprised of 34 borrowers and 305 savers.

Out of total assets of Rp 26.6 bn as of 12/1995, the bank had Rp 10.7 bn loans outstanding. Deposits in other banks amounted to Rp 11.4 bn; and reserves deposited in Bank Indonesia to Rp 0.54 bn. Equity capital amounted to Rp 10 bn; reserves to an astounding Rp 2,389.2 bn (including current and previous year profits); and savings deposits to Rp 13.9 bn - exceeding the volume of loans outstanding by a considerable margin. Profits for 1995 amounted to Rp 0.65 bn or 2.5% of total assets; 5.3% of the bank's net value; and 6.1% of loans outstanding.

As a large part of the bank's equity has been provided by a donor at no cost to the bank, the assessment of the bank's viability hinges on whether or not a market rate of interest is included in the calculation as a hidden subsidy. In the table below the hidden subsidy element is excluded from the sustainability calculations. The degree of partial financial self-sufficiency is 90%, the degree of full financial self-sufficiency 58% (157% if income from interbank deposits is included). The provision of equity capital has also contributed to the bank's overliquidity, which it has deposited in other banks. The loan to deposit ratio is still very low, but has increased substantially from 9.9% in 1993 and 24.25% in 1994 to 38.62% in 1995. With an average interest rate on deposit of 14%, a lending interest rate of 24% and a default rate of 1%, the bank may eventually become viable, provided it continues to expand its lending business. However, to cover the costs of an expanding microcredit business with the poor, it would have to substantially increase its interest rate.

Table 2.3: Selected indicators of viability in four MFIs in Indonesia, 1995

Indicator	MKEJ	P4K	Shinta D.	Purba D.
Av. interest rate on deposits	10.0%	10.0%	14.7%	14.0%
Interest rate to borrowers	30.0%	21.15%	27.4%	24.0%
On-time repayment rate	98.0%	94.0%	96.5%	96.5%
Default rate	1.0%	3.2%	2.0%	1.0%
Op'l cost/Total fin. services	20.0%	32.0%	16.5%	10.0%
Average cost of outside funds	3.5%	7.4%	16.5%	0.0%*
Savings available for lending	50.0%	20.0%	99.0%	168.0%
Partial financial self-sufficiency	110.0%	37.0%	111.0%	90.0%
Full financial self-sufficiency	39.0%	35.0%	96.0%	58.0%** (157.0%)

*) Bank Purba Danarta has received a major proportion of its equity capital of Rp 10 billion in the form of a grant which is thus not a (soft) loan and on which no interest is due.

**) Bank Purba Danarta has placed a substantial amount of excess liquidity in other banks (Rp. 11.4 billion; + Rp. 0.54 billion as required reserves in Bank Indonesia). If income from interbank deposits is included, the rate of full financial self-sufficiency jumps to 157% in 1995.

In sum, the Indonesian experience shows that viability and sustainability can be attained in banking with the poor and the near-poor. Technical assistance has usually played in key role in the transformation of subsidized programs into savings-driven viable institutions. Indonesia also shows that institutional viability can be achieved even under repressive policy conditions (before 1983), provided the institutions remain nonformal and apply their own sound practices. Capacity-building through training that may be provided by specialized bank training institutions and by qualified NGOs are a key input in the transformation process.

c. Resource mobilization

The sustainability of microfinancial services hinges on two main factors: the mobilization of internal resources and the soundness of financial practices in dealing with these resources. Internal resource mobilization makes microfinance institutions independent of government and donor funding. It is the heart of self-help. Major resources include share capital, savings deposits and profits. For some microfinancial institutions operating in the microeconomy, high interest rates on loans may be a very effective instrument of internal resource mobilization in addition to the collection of voluntary savings; this is a form of self-imposed compulsory savings mobilization frequently chosen by small institutions in the informal financial sector.

Savings products and innovations to be promoted may comprise convenient deposit facilities for the accumulation and safeguarding of savings for microenterprise self-financing, consumption and emergencies; positive real returns to prevent erosion by inflation; savings products that differ in yield, maturity and incentive structure, such as voluntary savings withdrawable at any time or fixed deposits vs. regular compulsory savings that are non-withdrawable, lottery savings, raffles, etc.; and collection services organized by institutions or customers such as daily, or some other form of regular, savings collection at doorsteps, with transaction costs of this service either borne by the saver (as in most informal arrangements) or by the deposit institution (as in most banks which offer this service). In small local microfinance institutions, high interest rates on loans may serve as a major mechanism of self-imposed compulsory savings mobilization.

In subsistence agriculture and in remote areas, particularly on the outer islands, and in marginal informal sector activities credit may be an inappropriate financial service. In this case savings promotion that strengthens the self-financing capacity of small farmers and microentrepreneurs and the provision of safe and convenient savings deposit facilities might be the most responsible financial service strategy.

Resources can be mobilized under any policy regime; but it is under in an environment of deregulated interest rates that resource mobilization flourishes, providing a source of self-financing to small farmers and entrepreneurs and a basis of self-reliance to financial institutions. By promoting, before deregulation in 1983, autonomous semiformal financial institutions that did not fall under the banking law, resource mobilization as their main source of funding was effectively encouraged. As these institutions found it difficult to collect voluntary savings with a negative rate of return, their chief instrument of fund mobilization was a drastically increased interest rate on credit - insuring at the same time that very scarce financial resources were allocated to investments with the highest rates of return.

After the deregulation of interest rates in 1983 and even more so after bank deregulation in 1988, resource mobilization skyrocketed in Indonesia, the former event making it attractive for individuals to save, the latter for institutions to expand their collection network. The effect of deregulation has been more pronounced on savings proper, an instrument of the poorer sections of the population, than on time deposits, an instrument of the non-poor.

Virtually all types of financial institutions now mobilize their own resources in Indonesia, from national banks like BRI to village banks, semiformal MFIs and informal SHGs, and, depending on the investment climate, they may do so in aggressive ways. Financial innovations flourish in this climate, with numerous new savings products emerging such as lottery savings and daily deposit collection at doorsteps. There is wide scope for further stepping up resource mobilization by documenting and disseminating information on such instruments. Institutions that resist innovation and continue to stick to their preferential savings and credit terms, like credit unions until a few years ago, found their growth impeded. It is only sound financial practices which strengthen institutions and provide incentives that motivate their owner and customers.

Convenient and safe savings deposit facilities are of particular importance to the poor who have demonstrated, time and again, a high propensity to save. In the case of **Bank Shinta Daya**, savings deposits amount to 105% of loans outstanding. But while the poor account for the majority of the bank's depositors, their share of the total amount of deposits is small. This has also been the experience of **Bank Purba Danarta**, our fourth case study. After it turned from an NGO intermediary into a formal bank, it was swamped with savings which, according to data from its balance sheet (end-1995), amounted to Rp. 13.9 bn by 1995. Only Rp. 10.7 bn of a total of about Rp. 22 bn in loanable funds were loaned out, and only 1% of this amount to poor borrowers. At the same time, its poor clients contributed 5% of the savings while 95% came from nonpoor clients as of 12/1995.[2] The bank now realizes it will take years to train the staff required to reach the vast numbers of savers and borrowers it ultimately wants to serve. **P4K** has another story to tell with regard to the poor's interest in savings. The project has a compulsory savings component adjusted to the average regular savings capacity of a group. As this is far from exhausting the savings capacity of the members and as the small groups of ten members each were found to be too small to serve as financial intermediaries, some groups started to join together in associations with weekly meetings at which savings are collected, loans disbursed and instalments repayment. The number of associations grew from 181 in July 1992, comprising 910 groups with 9,100 members, to 2,051 comprising 9,287 groups with nearly 100,000 members, i.e. about 28% of all project participants. They continue to spread like wildfire: during the half-year period from December 1995 to June 1996 their number grew by 36%. These associations form the nucleus of self-reliant and self-managed local financial intermediaries that might eventually grow into rural banks (BPR). As they are a by-product of the project, no statistics are available of their financial transactions.

Some data are given below on the volume of savings and loans in the four MFIs studied, yielding a very low savings ratio of not more than 0.2 for the two projects which heavily depend on donor funds, and a high savings ratio above 1.0 for the two banks which mobilize their own resources.

Table 2.4: Savings and loans in four MFIs in Indonesia, 1995

(amounts in million Rupiah)

MF	Savings mobilized	Loans outstanding	Savings ratio
MKEJ	12.3	73.6	0.17
P4K	4,157.2	20,455.7	0.2

[2] Indirectly this also indicates that an equity capital of Rp 50 million as required for the establishment of a rural bank of the BPR type (or several times Rp 50 million for several small autonomous rural banks) would have been adequate for meeting the credit demands of the market segment envisaged by the bank. This would also have avoided overliquidity and donor dependency.

Bank Shinta Daya	5,052.1	4,825.0	1.05
Bank Purba Danarta	13,908.0	10,708.0	1.30

Average deposits in the two projects, amounting to Rp 11,000 and Rp 13,000, respectively, are substantially lower than in the two banks with average deposits of Rp 167,000 and Rp. 1,430,000, respectively. To some extent this is due to the fact that the two project exclusively cater for the poor while the banks work with both the poor and the non-poor. However, this does not fully explain the difference as average deposits of the poor in the two banks, Rp 62,000 and Rp 70,000, respectively, are more than five-fold the deposits in the project-supported institutions. The decisive factor here is the savings mobilization technology: the two projects rely on regular compulsory savings which are invariably fixed at a minimum affordable by all group members while the two banks have more innovative savings products such as door step collection of savings and voluntary savings. The projects do not exhaust the savings capacity of their customers; or in other words: their savings deposit facilities for the poor are inadequate. The vast difference between the two banks in terms of average deposits from the non-poor, namely Rp 656,000 and Rp 15,290,000, is probably due to type of bank and their location, Bank Shinta Daya being a rural bank located in a rural area and Bank Purba Danarta a commercial bank located in the capital of the Region of Central Java.

Table 2.5: Number of depositors and average deposits of poor and non-poor customers in four MFIs in Indonesia, 1995

(figures in '000 depositors and Rp '000 deposits)

Depositors/deposits	MKEJ	P4K	Shinta Daya	Purba D.
Depositors	1.1	328,67	30	12
Poor	1.1	328,67	26	11
Non-poor	0	0	5	1
Average deposits	11	13	167	1,430
Poor	11	13	62	70
Non-poor	-	-	656	15,290

In sum, given the need of the poor for savings deposit facilities, it is all the more surprising that projects focussing exclusively on the poor as in the various Grameen Bank replications (including MKEJ) and *Small Farmer Development Projects* (including P4K) continue to be credit-driven and offer little in terms of innovative savings products with attractive returns and convenient collection services, with regular compulsory savings as promoted by these projects tending to restrict savings to the required minimum. Unless this is reversed, we may conclude that such projects may ultimately provide more of a disservice to the poor than a service, promoting indebtedness more than a healthy self-financing capacity. In particular, credit-driven poverty alleviation projects might miss the chance of assisting the poor in using their financial resources and the technical and financial assistance offered for establishing or strengthening their own MFIs.

d. Regulatory framework

The Indonesian experience shows that the establishment of MFIs and the outreach of existing financial institutions to the poor has been greatly influenced by two events: the deregulation of interest rates in 1983 which led to a surge in national resource mobilization and a multitude of financial innovations; and bank deregulation in 1988, which led to the establishment of a rapidly increasing number of village banks and the transformation of small institutions into rural formal sector banks. Both have greatly eased access of the poor to banking services and contributed to the reduction of poverty in Indonesia. However, there is still a felt need for another nationally recognized legal status for MFIs below the level of rural banks, including very small institutions such as self-help groups and self-help associations of the poor, or at least a recognized form of registration, particularly for the associations of groups formed under P4K. The need is also felt in Indonesia to create second-tier regulatory authorities, other than the Cooperative Department, which render appropriate guidance and supervision services to MFIs.

Indonesia has a deep experience in the promotion of MFIs, the expansion of microfinancial services and the alleviation of poverty. This experience indicates that changes in the policy and regulatory environment have been of crucial importance in that field. The Indonesian experience allows us to draw some general conclusions in that respect. For the further development of microfinance institutions and microfinancial services for the poorer segments of the population, **four policy measures** are of particular importance:

- **Deregulation of interest rates** to permit institutions to pay interest rates with positive real returns to savers and to charge interest rates on loans that cover their costs and permit profits from which their expansion is financed and owners are rewarded [*under conditions of nationally regulated interest rates:* granting of exemptions from interest rate regulation for a specific area, institution and time period]. The four MFIs studied have use of the opportunities offered by deregulation in varying ways, offering deposit rates ranging from 10% to 14.7% and charging average lending rates from 21% to 30%. They also allow a given institution to differentiate their interest rates according to loan product, depending on loan size, maturity and collection service.

- **Bank deregulation** to ease the establishment of new banks, branching out, *taking the bank to the people,* and to allow for the establishment of local MFIs with equity capital requirements that substantially differ from those for national banks. The transformation of the financial activities of NGO Purba Danarta into a commercial bank has been the direct result of this deregulation.

- **Provision of adequate forms of governance and legal status** for MFIs that may be owned by members, communities and stockholders (as in the case of Bank Shinta Daya) including NGOs (as in the case of Bank Purba Danarta). There is still a need for adequate forms of non-bank status for small and very small MFIs such as financial self-help groups (i.e., genuine *micro*-institutions)

- **establishment of second-tier regulatory authorities** which guide and supervise large numbers of small financial institutions that cannot be effectively controlled by the central bank: still largely a task of the future.

e. Sound microfinance practices[3]

Sound microfinance practices pertaining to microsavings, microcredit, and microinsurance are essential for the viability of MFIs and for a sustained increase in their service outreach. This is of particular importance in banking with the poor, hitherto thought of as unbankable. Successful MFIs with sustainable microcredit services in Indonesia have usually invented a host of instruments and strategies which differ from those used in banking with the urban or rural non-poor. There are probably not many countries with a wider spectrum of MFIs and a deeper experience with sound, or *best*, microfinance practices than Indonesia.

Microsavings products that may be used by formal, semiformal and informal financial institutions comprise withdrawable voluntary savings, time deposits, daily savings, doorstep service savings, nonwithdrawable compulsory savings, equity savings, rotating savings, savings with a lottery component, and savings tied in various ways to credit including savings build into the interest rate on loans.[4] They are major instruments in the hands of both formal and nonformal institutions to create their own deposit base. Savings products successfully used by **Bank Shinta Daya** include voluntary individual passbook savings and time deposits and compulsory group savings, with interest rates ranging from 12% on passbook savings to 15-21% p.a. on time deposits. **Bank Purba Danarta** has demonstrated its capability as a commercial bank to collect savings of the smallest sizes, i.e.. between Rp 100 and Rp 2500 ($0.04-1.09), from the poor. From each participant, the field staff collects fixed savings (*Bina Anggaran*) at door steps, using savings stamps, without recourse to the group technology!

The greatest challenge for indigenous informal financial institutions which normally mobilize their own internal resources and exogenous informal institutions contingent upon GO or NGO resources appears to lie in the development of a range of savings products differentiated according to yield and maturity, including voluntary withdrawable savings. The greatest challenge to banks, which frequently have access to easy money and cheap rediscounting facilities, is the development of attractive savings products and cost-effective collection services that minimize both the bank's and the savers' transaction costs – hinging on the decision to opt for long-term self-reliance and institutional sustainability rather than short-term donor dependency. From a customer's viewpoint it is important that institutions offer convenient deposit facilities for the safeguarding of their savings accumulated for agricultural

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[3] The World Bank has introduced the term *best practices.* This term evokes the notion of optimal practices applicable anywhere. In contract, experience has shown that *sound practices* vary by environment and must be adjusted to a given situation. What is sound in one situation may be unsound in another.

[4] Savings products and techniques of savings mobilization have been presented in the form of training modules in: Hans Dieter Seibel, Self-Help Groups as Financial Intermediaries: A Training Manual for Self-Help Groups, Banks and NGOs. Verlag fuer Entwicklungspolitik, Saarbruecken (Germany), 1992, pp. 99-112, 160, 174, 210

and microenterprise self-financing, emergency and consumption purposes. It is further important to customers that there is a positive yield in real terms lest their savings are eroded by inflation. Savings products differing in yield and maturity provide incentives to find the right balance between the institutions' concern for long-term deposits (as a basis of long-term loans) and the customers' liquidity preferences (in the form of savings withdrawable at any time): a particularly difficult task in inflationary economies. An additional function of savings lies in the establishment of a track record, providing inexpensive information on the creditworthiness of customers. Particularly in the case of the poor, a savings account provides easy access to a bank, allows familiarization with the bank and its corporate culture, and creates an opportunity for building up liquid collateral for loans.

Microcredit products[5] are more appropriately differentiated in terms of maturities, instalments, services and collateral requirements (ranging from joint liability and personal guarantees to tangible collateral and pawning) than in terms of loan use, which is costly to appraise and, for fungibility reasons, difficult to control. **Bank Shinta Daya** has two major categories of loan products: retail loans to individual customers and whole sale loans to groups which onlend to their members at terms determined by each group. It is the bank's basic principle to provide quick and convenient access to small and often short-term loans and to base subsequent lending decisions on repayment performance. It accepts collateral substitutes such as peer guarantees and, in the case of group loans, peer pressure. Bank Shinta Daya employs a fine-tuned loan pricing strategy which takes into customer category (groups, small entrepreneurs or farmers, wage or salary earners) and size of loan, collateral requirements, loan period and spacing of instalments. Loan products range from 3-6 months small loans up to Rp 5 million with weekly instalments at 30% interest p.a., directed mainly to the credit demand of small traders the majority of which are women; to 12-18 months loans above Rp 20 million with monthly installments at 27.5% p.a., directed particularly to small entrepreneurs). For the convenience of the customers, interest rates are stated as flat rates per month, ranging from 1.7% p.m. for the smallest-size and 1.25% p.m. for the largest-size loans, and instalments of a constant size throughout the repayment period. **Bank Purba Danarta** is a commercial bank that has demonstrated the viability of lending to the poor, employing two credit products: microloans of Rp 50-300,000 ($22-130) with weekly repayments and small loans up to Rp 1.0 million with monthly instalments.

Viable and sustainable microcredit schemes require: prudent adjustment to household savings, investment and repayment capacities; small loan sizes, with ceilings growing over a cycle of repeat loans up to a level determined by the absorptive capacity of the microenterprise and household economy; dynamically growing savings-to-credit ratios; market rates of interest autonomously determined by financial institutions and differentiated according to costs and services provided; loan maturities and repayment modalities according to customer needs and differentiated, in case of wholesaling, according for each level of intermediation; short maturities, no grace periods and short instalment periods in case of initial loans; insistence on, and incentives for, timely repayment; and the development and provision of cost-effective monitoring systems.

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[5] Credit products and techniques of appropriate credit disbursement have been presented in the form of training modules in: H.D. Seibel, Self-Help Groups as Financial Intermediaries, Saarbruecken 1992, pp. 123-140, 171-193.

Microinsurance[6] is the most underdeveloped part of microfinance. Yet various schemes exist that are viable, benefiting both the institutions and their clients. Such schemes have generally served two major purposes: They have contributed to loan security; and they have served as instruments of resource mobilization. Life and health insurance have been successfully incorporated into schemes of loan protection by the private credit union movement under the Credit Union Coordinating Office (CUCO), a member of WOCCU, in Jakarta. In other countries there are also successful examples of accident insurance and, since the days of Raiffeisen, of cattle insurance. There are no known cases of viable crop insurance schemes.

Product reciprocity ties credit to savings and insurance, and vice versa. It avoids moral hazard and improves financial discipline. For otherwise unbankable customers, it establishes a track record. To banks, it offers a cost-effective solution to the information problem.

Through **collection reciprocity** an institution may combine the collection of savings, instalments and premiums. This can be crucial to **arrears prevention** in the informal sector where incomes are daily or irregular, but not monthly, and are likely to escape collection without appropriate timing and collection techniques. Recovery rates can be further improved by tied lending, which interlinks credit with commodity transactions, which are widespread in the nonformal sector but may also be successfully applied by formal institutions.

Microfinance procedures and services should be set by financial institutions rather than government; be customer-oriented, i.e. simple, fast and on time; be market-oriented and in competition with those by other formal or nonformal institutions; and cover their cost. Financial institutions in Indonesia provide ample evidence of appropriate procedures and services geared to (1) sound financial management, (2) convenient and safe savings collection and deposit facilities, (3) appropriate loan appraisal and processing procedures, (4) adequate risk management (including collateral substitutes, nonformal collateral, loan protection schemes and prudent loan disbursement), (5) timely repayment collection, (6) monitoring and (7) effective information gathering, all of which may include cooperation between different formal and nonformal intermediaries according to their respective effectiveness and complementarity.

The terms and conditions of financial contracts must be sound from both an institution's and its customers' viewpoints. To arrive at balanced loan contracts, an exchange of experience and mutual learning may be required between the various types of nonformal and formal institutions including: (1) informal financial institutions with their wide range of contractual terms concerning interest rates, loan sizes, maturities, grace periods, loan purposes, reciprocities, collateral requirements, services, transaction cost sharing arrangements and unbounded innovations; (2) semiformal financial institutions including projects and programs, which tend to be influenced by governmental or non-governmental donors and may combine comprehensive nonfinancial services with a lack of commercial orientation; (3) formal institutions on tightly regulated markets, with a narrow and usually inflexible range of contractual terms (or failing to utilize the freedom granted by deregulation); and (4) formal institutions on deregulated markets with their much wider range of terms, transaction cost

[6] Microinsurance products are introduced in some training modules in: H.D. Seibel, Self-Help Groups as Financial Intermediaries, Saarbruecken 1992, pp. 141-142, 194

sharing arrangements and innovations. In Indonesia, this learning process has been systematically promoted by Bank Indonesia through its linkage banking project, PHBK.

Ultimately savers and borrowers must be regarded as a **market** for financial institutions: with the institutions as intermediaries and savers and borrowers as customers rather than beneficiaries. Contractual terms and conditions on that market are the result of negotiation and competition rather than administrative imposition and convenience. With increasing institutional diversification, there has been mounting competition among institutions at least in the more densely populated parts of Indonesia. This is one of the best guarantee for balanced loan contracts that do not ignore the interests of the poor.

f. Individual vs. group microfinance technologies

The effectiveness of the individual vs. the group microfinance technology is presently being hotly debated, sometimes to the point of holy warfare as evidenced during the Bank Poor '96 workshop in Kuala Lumpur in December 1996 and the Microcredit Summit in Washington DC in February 1997. Examples for the success of each basically attest to the feasibility of each approach but leave open the question as to the conditions under which each is most appropriate and to their relative effectiveness. What makes a comparative evaluation difficult is the fact that most institutions or programs are specialized on one of the two technologies. Moreover, the individual technology is usually employed by banks and the group technology in NGO and GO projects, which means that any result is simultaneously determined by type of technology and type of institution. Of the institutions studied in Indonesia, MKEJ and P4K which exclusively cater for the poor are specialized on the group technology, Bank Purba Danarta which caters for the poor and the non-poor on the individual technology. Further limitations derive from the fact that the two technologies are frequently not applied to both savings deposit collection and credit; and that banks frequently cater for the non-poor and NGOs for the poor. How are we then to compare the effectiveness of NGOs lending to the poor indirectly through groups with banks collecting savings from and lending directly to the non-poor as individuals?

Among the four case studies from Indonesia there is one of an institution which employs both technologies; applies them to deposit collection as well as credit delivery; and caters for the poor and the non-poor: **Bank Shinta Daya** in Kalasan. The existing data for December 1995 allow us to analyze the effectiveness of the two technologies with regard to savings deposits, credit and profitability to the bank. Bank Shinta Daya started its individual savings and credit business in 1970. In 1989 it started experimenting with the group approach through a local NGO as financial intermediary: the bank lent to the NGO which onlent to the self-help groups under its guidance which in turn lent to their members. The NGO had been previously involved in the disbursement of donor-provided funds to a large number of widely dispersed groups and regarded the bank as a welcome new donor. The experience ended in disaster. Losses amounting to about $50,000 were equally shared between the bank and Bank Indonesia, which had supported the experiment (though without credit guarantees). Instead of giving up on group lending, Bank Shinta Daya, like any good banker, learned from the experience. It abandoned its cooperation with the NGO and its pampered groups and started to select and train local self-help groups with well-established internal savings and credit activities through its own SHG department. The bank's experience with the group technology is thus relatively young. Its business with self-help groups has been rapidly expanding and is expected to expand further.

As of December 1995, the bank worked with 310 groups selected from within the vicinity of the bank, with a total of 7,750 members. As of 12/1995 7,400 of them were active savers and 6,200 active borrowers of funds lent by the bank wholesale to the SHGs. At the same time the bank had 22,940 individual depositors and 6,456 individual borrowers. Savers and borrowers cannot be added up to arrive at the total number of customers. The practice in small banks in Indonesia is that opening a savings account precedes a credit application, with the result that the number of savers equals more or less the total number of customers.

With regard to savers, the group technology has enabled the bank to expand its clientele by about one third. Three quarters of its depositors are individual customers (75.6%), one quarter are group members (24.4%). However, there is a wide differential between individual and group savers in terms of the amount deposited: of the total amount of savings deposits 96.9% have been mobilized from individuals and only 3.1% through groups. The difference is due to savings techniques: savings from individuals are voluntary; savings through groups are compulsory, regular and standardized at a minimal level that is affordable by each member of a group.

Even before the adoption of the group technology the bank dealt with large numbers of poor depositors. As of 12/1995 18,352 (or 80%) out of its 22,940 individual depositors were poor. The group technology has enabled the bank to expand its outreach to poor depositors by 40%, namely from 18,352 individual poor savers by 7,400 group members, who are all poor, to a total of 25,752. Of the bank's poor depositors 71% are individual customers and 29% group members. Among the poor customers of the bank, 90% of the volume of deposits has been collected from individuals and 10% through groups.

There are two conclusions: (1) the group technology increases the bank's outreach to depositors including the poor by a notable margin, but adds little to the overall volume of resources mobilized; (2) the bank's individual approach is savings-driven, its group approach is not.

Table 2.6: Savings mobilization through individual and group technologies in Bank Shinta Daya

	Individual	Group	Total
Depositors:			
Number	22,940	7,400	30,340
Percent	75.6%	24.4%	100.0%
Poor depositors only:			
Number	18,352	7.400	25,752
Percent	71.3%	28.7%	100.0%
Amount of deposits in %:			
All	96.9%	3.1%	100.0%
Poor only	89.9%	10.1%	100.0%

With regard to borrowers, the group technology has enabled the bank to double its outreach: from 6,456 to 12,656 borrowers, but has added relatively little to the volume of loans outstanding. Group members represent 49% of borrowers but only 11% of the volume of loans outstanding.

Through the group technology the bank has increased its outreach to poor borrowers substantially, namely from 2,582 by a margin of 240% to a total number of 8,782. 29% of its poor borrowers are individual customers, 71% are group members. Average loan sizes of individual borrowers are more than two times bigger than those of group members, with the result that the volume of loans outstanding from the poor are in the hands of the much smaller number of individual borrowers.

Two conclusions may be drawn: (1) the group technology vastly increases the bank's outreach to the poor but adds relatively little to the its overall lending volume; (2) the individual approach allows for larger average loan sizes to the poor than the group approach - a finding which requires further research. It is not clear to what extent these are two different categories of the poor; or whether individual lending allows for more differentiated loan screening while the group approach suffers from an inherent regression to the mean.

Table 2.7: Credit delivery through individual and group technologies in Bank Shinta Daya

	Individual	Group	Total
Borrowers:			
Number	6,456	6,200	12,656
Percent	51.0%	49.0%	100.0%
Poor borrowers only:			
Number	2,582	6,200	8,782
Percent	29.4%	70.6%	100.0%
Loans outstanding in %:			
All	89.3%	10.7%	100.0%
Poor only	48.4%	51.6%	100.0%

Both technologies are profitable to the bank. That means they not only allow the bank to cover their costs but also to make a profit. However, the contribution of the group business to the bank's profits is only 6%. Group lending is also less profitable than individual lending, with profits from individual lending amounting to 2.6% of individual loans outstanding and profits from group lending amounting to only 1.4% of group loans outstanding (table 2.8; cf also table 2.2).

Table 2.8: Profitability of individual and group technologies in Bank Shinta Daya

	Individual	Group	Total
Net profit of the bank	94.0%	6.0%	100.0%

Profit in % of loans outstanding	2.6%	1.4%	2.5%
Profit in % of total fin. services	1.2%	1.1%	1.2

Yet the bank finds the group technology promising. It allows the bank to capture a new market segment which the bank hopes will benefit from the access to its financial services. As the microenterprises of the group members grow, so will their business with the bank: either mediated by the group or, if their financial needs exceed the capacity of what the group wants to handle, in a direct business relationship, i.e. after *graduation.*

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